Division of Agricultural Sciences
UNIVERSITY OF CALIFORNIA

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What You Should Know About

Farm Leases

CALIFORNIA AGRICULTURAL
Experiment Station
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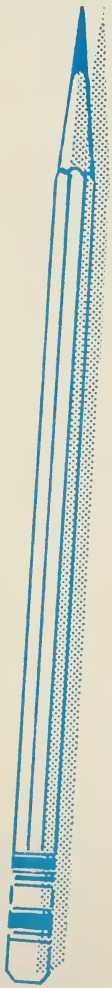
CIRCULAR 491

This circular aims at helping tenants and landlords in drawing up mutually satisfactory leases. Use of a farm lease worksheet, adapted from the sample reproduced below, may assist you in determining an equitable rent for your individual lease situation.



Farm Lease Worksheet

Owner _____ Tenant _____ Date _____
Farm _____

INVESTMENT EXPENSE

	Total investment	Landlord			Tenant		
		Investment	Interest	Depreciation	Investment	Interest	Depreciation
Land							
Buildings							
Irrigation system							
Fences							
Trees, vines, crops							
Tractors & trucks							
Machinery							
Livestock							
Operating capital							
TOTAL							

DISTRIBUTION OF EXPENSE

	Total value	Landlord		Tenant	
		Description	Value	Description	Value
Noncash costs					
Interest					
Depreciation					
Unpaid labor					
Management allowance					
Cash costs					
Hired labor					
Contract work					
Dust					
Seed					
Fertilizer					
Spray material					
Gas & oil					
Repairs					
Water or power					
Feed					
Veterinary					
Supplies					
Hull & dry					
Taxes					
Insurance					
Office expense					
Dwelling					
Other					
TOTAL COSTS					
Per cent	100				

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WHAT YOU SHOULD KNOW ABOUT

Farm Leases

TENANTS OPERATE approximately 11 per cent of California farms, including all types of agricultural enterprises. Rental rates and leasing arrangements vary widely, depending on type of enterprise, productivity, size, location, and other factors.

Leasing arrangements must be tailored to each individual case but should be based on conditions such as

- a mutual feeling of trust
- a satisfactory potential income for tenant and landlord
- a rental rate equitable to both parties
- a written lease using clear, understandable words.

What to include

Legal advice will help prevent subsequent difficulties. In general, every lease should at least contain the following:

Date of lease.

Names and addresses of all parties concerned.

Description of the property:

Location as to county and state,
Legal description,
Acreage,
Specification of parcels of land or buildings being retained by the landlord.

Terms of lease:

Dates of start and termination of the lease,
Provision for automatic continuation on a year-to-year basis unless termination notice is given by either party before a specified date,
Rental rates for each enterprise,
Expenses to be borne by each party concerned,
How, when, and where rent is to be paid,
Management practices to be followed such as:
  Acreage of crops
  Rotations
  Numbers of livestock
  Improvement practices,
Provision to reimburse tenant at termination of lease for improvements made at his expense and not fully used up,
Provision for settlement in case of death,
Provision for arbitration in case of disagreement.

Signatures of all parties.

Legal requirements

A lease is a contract, a promise enforceable by law.

A valid contract must meet certain legal requirements. Among them are:

Consent of the parties: All parties to be bound by the contract must consent positively. Lack of a negative answer cannot bind a person to a contract.

Parties competent to enter into contract: Persons under 21 generally do not have full capacity to make contracts; neither do insane persons, intoxicated persons, and convicts. Corporations, by their charter, may have limited contracting power.

Consideration—the price which one party pays for another's promise: The price need not be in terms of money but is essentially the conduct, or the promise of conduct, of one party given in exchange for the conduct, or promise of conduct, of the other party to the transaction.

Purpose of the contract must be legal.

Contracts which cannot be performed within one year must be in writing to be enforceable.

Agricultural lands in California may be leased for no more than 15 years under one contract.

Determining the rent

Rent, being the price for the use of land or other productive factors, is determined by demand and supply. There are, however, many reasons why it is difficult for tenant and landlord to arrive at and to maintain a rental arrangement fair to both.

Rents often become established at a "customary" rate. But there are situations where no customary rate has been established, such as for enterprises which have not normally been rented, or for new enterprises developed in an area.

But also in situations where customary rates have been established, tenants and landlords will do well to constantly reappraise the existing rates, or they may find themselves at a disadvantage. Rental rates should respond to changes in cost-price relationships, introduction of new machinery, development of higher-yielding varieties, production shifts from one area to another, increasing farm size, need for greater managerial ability, and others.

This circular cannot, of course, determine the rent for you. This is your job to be done by individual bargaining. This circular, however, presents to you a method that will assist you in arriving at equitable rental rates.

HOW TO FIGURE EQUITABLE RENTAL RATES

An equitable rent, as usually defined, is one where landlord and tenant share the gross income in the same proportion as they contribute to the costs of production. To establish a fair rent:

Determine the contributions made by each party,
Assign appropriate values to these contributions,
Establish the share of the total costs contributed by landlord and tenant.

List the following contributions in some logical manner. Use of a form like the farm lease worksheet on page 2 may be helpful.

NONCASH COSTS

Investment. The capital or investment furnished by each party is made a part of annual costs by including interest on such investments. Figure land at a sound agricultural value. Few agricultural tenants can pay a rent which reflects subdivision values. Figure buildings, equipment, and other depreciable facilities at current depreciated values, or at about half of the replacement cost. Include only necessary items and only at values which would ordinarily provide adequate facil-

Farm Lease Worksheet

Owner _____ Tenant _____ Date _____

Farm a 40 acre walnut orchard in Sacramento Valley. Landlord furnishes all the investment. Yield – 2,000 lb per acre

INVESTMENT EXPENSE

	Total investment	Landlord			Tenant		
		Investment	Interest	Depreciation	Investment	Interest	Depreciation
Land	$24,000	$24,000	$ 1,200	$			
Buildings	5,000	5,000	125	333			
Irrigation system	4,000	4,000	200	267			
Fences							
Trees, vines, crops	32,000	32,000	800	800			
Tractors & trucks Machinery	8,400	8,400	210	560			
Livestock							
Operating capital							
TOTAL			$ 2,535	$ 1,960			

DISTRIBUTION OF EXPENSE

	Total value	Landlord		Tenant	
		Description	Value	Description	Value
Noncash costs					
Interest	$ 2,535		2,535		
Depreciation	1,960		1,960		
Unpaid labor					
Management allowance					
Cash costs					
Hired labor	2,800			All labor	2,800
Contract work	200			Haul 40 ton @ $5	200
Dust	200			1,200 lb @ 16⅔¢	200
Seed					
Fertilizer	600			4,000 lb N @ 15¢	600
Spray material	640				640
Gas & oil Repairs	436				436
Water or power	200				200
Feed					
Veterinary					
Supplies					
Hull & dry	1,280			40 ton @ $32	1,280
Taxes	240		240		
Insurance	200		200		
Office expense					
Dwelling	420	@ $35 month	420		
Other	200				200
TOTAL COSTS	11,911		5,355		6,556
Per cent			45		55

ities. Neither party should include investments of unnecessary or overly expensive buildings and equipment. Figure interest on the total investment of each party at an agreed-upon rate, such as 5 or 6 per cent. Interest actually paid on debts by either party is ordinarily not considered; such outlays are covered by total interest on the investment.

Depreciation. The annual decline in value of buildings, irrigation system, equipment, trees, and other capital investments through use or increasing age is a proper part of annual costs. Estimate depreciation by dividing cost of each facility by probable useful life.

Unpaid labor. Make an allowance for the actual operator and family labor fur-

Tomatoes in Woodland Area

COSTS PER ACRE

Landlord Contribution	Per Acre Cost	Tenant Contribution	Per Acre Cost
Investment		Investment	
Land $ 700 per acre		Tractors & equipment $ 80 per acre	
Interest @ 6 %	$ 42.00	Interest 6% on ½ or value	$ 2.40
Buildings $ 10 per acre		Depreciation $80 for 10 yrs.	8.00
Interest @ 6 % on ½ or value	.30		
Depreciation $ 10 for 20 years	.50		
Irrigation wells & pumps $ 50 acre			
Interest @ 6 % on ½ or value	1.50		
Depreciation $ 50 for 20 years	2.50		
Taxes	8.00	Cash costs	
		Cultural labor 16 hrs. @ 1.25	20.00
		Thin	7.00
		Hoe 2 times	20.00
		Tractor fuel & repairs	10.00
		Machinery repairs	1.75
		Seed ½ lb. @ $10	5.00
		Fertilizer 60 lbs N @ 15¢	9.00
		Water 4 ac. ft. @ 2.45	9.80
		Dusting 3 times	8.85
		Social security, labor camp, office supervision, transportation, etc.	72.00
		Harvesting 20 ton @ 9.80 Includes picking, box rent, loading inspection, labor contractor, Growers Association, and grade loss	196.00
TOTAL	$ 54.80		309.80
Per cent	15		85

nished by each party at going wage rates and include it in the total costs.

Management allowance may also be a proper part of total costs; if so, list it under distributions of expenses, divided in the same way as the landlord and tenant share in the managerial duties and responsibilities. Management can be valued on the basis of charges made by professional managers—for example, 5 per cent of the gross income for actual management, or 10 per cent where the manager also defrays costs of office facilities, accounting, travel, and other expenses associated with management.

Cash costs. Credit each party with production, harvesting, and overhead cash expenses paid by that party. These

Cotton—San Joaquin Valley

COSTS PER ACRE

Landlord Contribution	Per Acre Cost	Tenant Contribution	Per acre Cost
Investment		Investment	
Land $ 600 @ 6%	$ 36.00	Tractors $ 50 per acre	$
Irrigation system $ 80 acre		Interest $ 25 @ 6%	1.50
Interest $ 40 @ 6%	2.40	Depreciation $ 50 for 15 yrs	3.35
Depreciation $ 80 for 17 yrs.	4.70	Equipment $ 15 per acre	
Buildings $ 10 per acre		Interest $ 7.50 @ 6%	.45
Interest $ 5 @ 6%	.30	Depreciation $ 15 for 10 yrs	1.50
Depreciation $ 10 for 20 yrs.	.50		
Taxes	5.00	Cash Costs	
		Labor & tractor cost	49.50
		Seed 20 lbs @ 8¢	1.60
		Power to pump 3 ac. ft. @ 2.60	7.80
		Fertilizer 80 lbs N @ 8¢	6.40
		Spraying	10.30
		Dusting	5.25
		Taxes	2.00
		Office & misc. overhead	7.50
		Miscellaneous repairs	3.50
		Defoliation	4.45
		Picking	37.25
Ginning, etc. 1/4	7.50	Ginning, etc. 3/4	22.50
TOTAL	56.40		$ 164.75
Per cent	25		75

costs may be estimated from previous records, from recent cost studies, or from cost standards available from such sources as the University of California Agricultural Extension Service. These expenses are important, so considerable care and local inquiry are justified.

Dwelling. A dwelling furnished by the landlord and used by the tenant can be included in the investment of the landlord. In this case interest and depreciation plus cash costs of taxes, repairs, and insurance would be credited as annual costs contributed by the landlord.

It is, however, preferable to keep the dwelling completely separate from the contributions of the landlord, and include a provision that the tenant pay a cash rent for its use. This method separates the home from the business, and places a market value rental on its use rather than tying the house rent to the productivity of the farm.

A GUIDE FOR FINDING A FAIR RENT

After listing the annual contributions of landlord and tenant, add each list and determine the proportion which each party contributes to the total production cost.

The percentage contributed by the landlord can be used as the share rent, or it can be multiplied by the probable price to arrive at a cash rent. If the percentage of the costs furnished by the landlord is too far from the usual or "customary" share, and it is desired to use the customary rate, some of the contributions may be shifted from one party to the other to make the percentages fit the local rental rate. Changing the contribution from one party to the other may also equalize the risks borne by the landlord and tenant or contribute to more efficient use of some resources, e.g. where fertilizer cost is divided between the parties.

This method does not determine what the exact rent should be, but provides a guide as to what the rent might be. The exact rent must be determined by bargaining between the parties, considering prevailing local rates.

EXAMPLES OF DETERMINING EQUITABLE RENTS

The accompanying examples are given to illustrate the procedure that can be used to determine equitable rents; they are *not* included as examples of what the rent should be.

The worksheet for the lease of the walnut orchard on page 5 indicates an equitable rent of 45 per cent of the crop if the landlord furnishes all of the investment and the tenant pays all of the operating expenses.

If the landlord hulls and dries half of the crop, it increases his contributions by $640, to a total of $5,995. It reduces the tenant's contributions by $640, to $5,916. Under these conditions, a 50 per cent rent would be equitable.

The rental value of the dwelling was included to show how it could enter into the determination of rent. The preferable method might be for the tenant to pay $35 cash rent per month for the dwelling and not include it in the calculation of rent for the orchard.

The worksheets on pages 6, 7, and 9 are adapted from the sample sheet on page 2 to cover lease arrangement of a tomato farm in the Woodland area, for cotton in the San Joaquin Valley, and the rent of a dairy cow.

SLIDING SCALE OR FLEXIBLE RENTS

Many landlords and tenants find a sliding scale or flexible rent desirable. Under these arrangements the amount of cash rent or the percentage of share rent varies with price or yield. In some cases the rent varies directly proportional to the change in either price or yield; other arrangements include some arbitrary deviation from the direct relationship. Usually income variations accompanying changes from a direct relationship be-

tween rent and price result in the landlord assuming a larger share of the risk associated with price or yield drop, than would otherwise be the case. The landlord is able to stand this risk because a larger proportion of his contributions to the business is noncash.

Sliding scale cash rent. Under this system, the cash rent is set to vary with the price of the product. A basic rental rate is usually established at some stipulated selling price. Then provisions are made for set increases or decreases in the rent as prices rise or fall. The actual rent is determined only after the commodities are sold and the actual selling price is known. Where several marketing outlets are available, it may be desirable to base the rent on some established and well recognized market quotation for the product rather than on the actual selling price. This protects the landlord from poor marketing practices by the tenant, and gives the tenant the advantage when he does a particularly good job of marketing.

The amounts of rent actually paid under these systems do not necessarily change in direct proportion to the changes in price. In many cases they are set up so that proportionately less rent is paid at low prices and higher rent at high prices.

Sliding scale share rent. Since the actual rent collected by the landlord under a share rent agreement varies proportionately with the yield and with the price, there is not a great deal of interest in a sliding scale share rent. However, this method is used in some areas of relatively high risk.

A sliding scale share rent is based on price or on yield. If based on price, the share rent is established at some given price, and goes up or down with the actual price received.

For example, the 15 per cent rent in the tomato example given on page 6 might be established at a price of $22 per ton. If the price increased to $23, the rent might be 16 per cent or, if the price dropped to $21, the rent would be

Rent for a Dairy Cow

	Renter has cow continuously		Renter has cow during lactation	
	Renter	Owner	Renter	Owner
Hay, 3 ton @ $	$ 75		$ 63	$ 12
Concentrate, 1 ton @ $ 50	50		50	
Pasture, 8 months @ $ 4.50	36		32	4
Labor, 80 hrs. @ $ 1.25	100		94	6
Testing, taxes, etc.	22	3	22	3
Breeding fee	8			8
Depreciation	10	30	10	30
Interest	22	14	22	14
Mortality		8		8
TOTAL	$ 323	$ 55	$ 293	$ 85
Less value of calf	15			15
Adjusted TOTAL	$ 308			$ 70
Per cent	85	15	81	19

14 per cent. There is periodic interest in this type of rental rate but very few actual leases are drawn up on this basis.

A sliding scale share rent based on yield is more common, particularly in areas of rather frequent near failures of the crop. Usually the tenant pays no rent if the yield drops below some predetermined level and the share rent gets progressively higher as the yield increases.

A variation to the above deal is where no rent is paid below a certain yield level but above this point the rent is higher than that indicated by the method of determining equitable rents.

Sliding scale share rents have to be based on some arbitrary agreement because these arrangements are a deviation from the equitable rent which would be obtained by using the method described earlier. These arrangements can be defined as equitable only in terms of easing the burden of the tenant under conditions of low price or low yield. They represent protection against unusual, but potentially disastrous, income hazards.

In short, to improve your leases:

- Periodically review the leasing arrangements to determine if they are equitable.
- Consider some form of sliding scale rent to reduce undue risk to either tenant or landlord.
- Provide for automatic renewal unless terminated by either party.
- Protect yourself and your heirs by having the lease in writing.

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Consider YOUR Future in Agricultural Economics

Agricultural economics applies SCIENCE to the BUSINESS OF FARMING . . . to the marketing of farm products, to the use of agricultural and range resources.

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For more information: Write to the Department of Agricultural Economics, University of California, Davis.

or: See your University of California Farm Advisor for college entrance requirements.